BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its own motion, to make adjustments to the universal service fund mechanism established in NUSF-26	**Application No. NUSF-50 Progression Order No. 1**

QWEST CORPORATION'S REPLY COMMENTS TO PROGRESSION ORDER NO. 1

Qwest Corporation ("Qwest") submits its reply comments to Progression Order No. 1 entered January 18, 2006 (*"Progression Order No.1"*) as follows:

Introduction

As an initial matter, Qwest continues to stress the importance of coordinating any solutions reached in this *Progression Order No.1* with the decisions in the other two progression orders in this docket and docket C-3554. These solutions must logically, legally, and factually "match" each other or else the solution in any one of these four dockets could render the other solutions improper or unsustainable.

That said, several commenters noted in the initial comment cycle that for the Commission to change the NUSF-26 methodology conflicts with the requirement that universal service funds be "predictable," and is inconsistent with the idea stated in the caption and throughout that docket that the purpose of Docket NUSF-26 was to establish a "Long Term Universal Service Funding Mechanism." As such, these comments at least implicitly – and in some cases explicitly – contend that the solution is to return the surcharge to its previous levels or to a level between the current 5.95% rate and the former rate of 6.95%. However, returning the surcharge to 6.95% could create problems of its own, and appears to be outside the scope of this docket, so Qwest offers no comment or position on such a solution. Qwest does, however, have a position on the issues addressed by the Commission's initial order in this *Progression Order No.1* and addressed in Qwest's initial comments, and supplies its reply comments on those topics below. Qwest's comments will follow the same structure as its prior comments, addressing the Commission's questions in turn.

1. Further Reducing Distributions Can Disproportionately Harm Qwest.

Some commenters suggest that the NUSF-26 mechanism remain untouched, or that the Commission simply cut the base support allocation to account for the lower surcharge payments. As stated in Qwest's initial comments, this solution disproportionately harms Qwest, in large part due to the enormous amount of support the Commission ports to competitive NETCs for serving in-town business and residential customers for which Qwest receives no support. In addition, it is not clear that reducing the base support allocation is absolutely necessary. The solutions that Qwest proposed in its opening comments, which better meet the goals of the NUSF and recognize the practicalities of a lower surcharge, should be considered by the Commission first before lowering the base support allocation.

2. The Commission Should Reduce the Rate of Return for Carriers as a First Choice.

The Rural Independent Companies ("RICs") contend that the rate of return caps operate as a limit and not a guarantee of a certain level of profitability, in contrast with federal fund distributions, which in some cases virtually guarantee a certain rate of return. As a result, the RICs argue that the current caps should be retained. These arguments miss the point, because they are made from the perspective of traditional ratemaking. Because the surcharge has been reduced, the fund cannot afford to provide for carrier profitability to the extent the prior surcharge did. Reducing the rate of return recognizes the practicalities of the reduced surcharge, and would also equitably apportion the "pain" of decreased distributions, such that carriers whose earnings are not adversely impacted by their own high investment levels or competition receive a softer blow, while high-earning carriers merely have their total earnings brought closer in line with the rest of the industry in Nebraska. This is a far more equitable and reasoned solution than arbitrary, across-the-board reductions for all carriers.

Citizens Telecommunications Company of Nebraska dba Frontier Communications of Nebraska ("Frontier") argues that decreases in the rate of return limits would discourage investment and increases in efficiency. These arguments are misplaced. First, any reduction in distributions will discourage investment. If the Commission reduces distributions to any carrier through any mechanism, that carrier's incentives and ability to invest will be decreased. Second, carriers that increase their efficiency and decrease their costs, such that their profitability is high, actually prove their need for lower levels of support. The Commission may desire to monitor the investments and expenses associated with providing universal service, and avoid rewarding or supporting the inefficiencies of carriers, but the presence of competition and high levels of investment – both goals the Commission supports – are far more powerful factors in determining a carrier's profitability than any incentives created by supporting carriers to a 12% rate of return.

Frontier, the RICs, and the Rural Telecommunications Coalition ("RTC") note that investments in a certain year may be uneven, or the depreciation lives may extend over a period of years such that rate of return caps are unfair. Predictability issues aside, the result of "lumpy" investment as described by the RTCs, or extended depreciation lives as described by Frontier, is the same regardless of the particular level of a rate of return limit. Reducing the rate of return limit will have no additional impact on the incentives or ability of carriers to invest, beyond the fact that any decrease in distributions negatively impacts the ability of any carrier to invest, regardless of depreciation lives.

3. *The Commission Does Not Need to Change The Way Earnings Are Calculated.*

The only other party to provide comments on this issue was the RIC group, and Qwest agrees that the Commission does not need to change the way earnings are calculated. Qwest disagrees, however, with the reasoning behind the RIC position. There is presently a cap on overearnings redistribution ("OER"). That cap is the current rate of return cap. Since the NUSF-26 available funding will be reduced due to the lower surcharge, reductions in the rate of return cap will accordingly lead to reductions in the OER. These actions would result in a total decrease in NUSF-26 distributions.

In addition, if the Commission changes the way earnings are calculated, the Commission's goal in making such a change should be to measure earnings more accurately, and reflect the market position of carriers and their ability to support the services they provide from end users compared to other sources, not merely to reduce support eligibility. If measuring carrier earnings more accurately and comprehensively results in a reduction in support for a particular carrier, that would be a fair result.

4. The Commission's Proposed Method To Adjust Support to Carriers Consistently Exceeding The Rate of Return Caps Is Reasonable.

Qwest offers no reply comments on this topic, but reserves the right to present testimony and further comment, as applicable.

5. Qwest Reserves Its Position On Raising The Local Rate Benchmark to $18.50.

Qwest presently takes no position on raising the benchmark, but reserves the right to respond in further comment and testimony to other parties' comments and testimony on this issue.

6. The Commission Should Keep Transitional Support Mechanisms In Place.

Several commenters suggest that the transitional mechanisms be reduced, accelerated, or eliminated. It is notable that most of these carriers do not benefit from these mechanisms. It is also notable that the RIC group, most of whose members do not benefit from the transitional mechanisms, agrees that the transitional mechanisms should remain unchanged. The Commission found just over a year ago that "this transition period allows carriers an opportunity to make adjustments, prevents undue hardship to customers and is in the public interest." The importance of allowing carriers to make adjustments and preventing undue hardship to customers has not changed as a result of the lower surcharge rate. And as noted in Qwest's initial comments, reducing, accelerating, or eliminating the transitional mechanisms would be particularly catastrophic for Qwest, which currently relies on those transitional mechanisms for most of the support it receives.

7. *Access Reductions Must Be Revenue-Neutral; Thus, As NUSF Distributions Are Decreased, The Commission Must Allow Carriers to Return Access Rates To A Revenue-Neutral Rate.*

Qwest reiterates its position that any switched access rate increases that the Commission allows ETCs to make in response to decreased NUSF support must be revenue-neutral. Qwest does not believe that ETCs should be allowed to increase switched access rates with the same freedom non-ETCs currently have, but Neb. Rev. Stat. § 83-323(7) requires the NUSF to "replace" implicit support from switched access rates, and Commission orders in NUSF-28 recognize that if NUSF funding is reduced, companies should be permitted to return switched access rates to a reasonable level. AT&T argues that allowing carriers that have decreased switched access rates with the promise of compensating NUSF support is not a competitively neutral solution. This argument is incorrect. Forcing ETCs to reduce their access rates while other carriers' access rates remain untouched – the Commission's initial approach to NUSF support – was competitively neutral, but only because the Commission provided support to offset those rate reductions. Like many other carriers in Nebraska, Qwest competes with several non-ETC carriers with far higher switched access rates. These non-ETC carriers enjoy a competitive advantage if their switched access revenue opportunities exceed the revenue ETCs gain from lowered access rates plus NUSF high-cost support. Allowing revenue-neutral access rate corrections if NUSF support is reduced merely restores competitive neutrality to the NUSF and switched access rate systems.

Conclusion

In conclusion, Qwest notes the RTCs comment upon the impact that the FCC Intercarrier Compensation Docket could have on the underlying assumptions of NUSF methodologies and mechanisms. In order to avoid a short term fix, in addition to coordinating any conclusions reached in this docket with the other current related dockets mentioned above, the Commission should remain mindful of the issues being discussed at the Federal level, and ensure that there is enough flexibility in the new plan to adapt to what the FCC does.

Dated Friday, May 12, 2006.

Respectfully submitted,

QWEST CORPORATION

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Comments of Qwest Corporation was sent regular U.S. Mail, on this 12th day of May, 2006, addressed as shown below, to the following:

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